# Don’t Be Caught Asleep At The Switch: 401(k) Best Practices

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# Agenda

- What is a fiduciary? (& why do I care?)
- What fiduciaries are responsible for
- The importance of reasonable fees
- Fund selection issues
- Litigation/Audit landscape
- Your Financial Wellness Score

# What is a fiduciary?

- ERISA 3(21)(A) defines fiduciary as one who -
  - Exercises any discretionary authority or control over the management of a plan, or over the management or disposition of plan assets;
  - Has any discretionary authority or discretionary responsibility in the administration of the plan; or
  - Renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan.

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# POLL QUESTION

- Who do you think is a fiduciary with respect to your retirement plan?
  - Me
  - The Company
  - Our HR Manager
  - Our Payroll Clerk
  - Our TPA
  - Our financial adviser

# Who are those '3' guys?

- 3(16) – Responsible for managing the day-to-day operation of the plan
  - Some responsibilities may be assigned to others
- 3(21) – paid professional who provides investment recommendations to trustee/ plan sponsor
- 3(38) – paid investment manager who makes the decisions and takes actions to implement

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# Why is it important to know?

- Subject to a higher standard of conduct
- These are the individuals that govern the plan and the choices that affect the administration
- Possible legal and financial liability

# Who is usually a fiduciary?

- Employer/Plan Sponsor
- Named Fiduciary in document
- Plan Administrator
- Trustee
- Investment Adviser
- Plan committee members
- Those exercising discretionary control

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# How do you identify a fiduciary?

- Plan document
- Resolution appointing committee members
- Contracted 3(16) third party administrators
- Contracted 3(21) or 3(38) investment advisers
- Whoever makes day-to-day deci
  - Discretionary functions performec

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# Key responsibilities

- Act exclusively in the best interest of plan participants and beneficiaries;
- Carry out duties prudently;
- Following the terms of the plan documents;
- Diversifying plan investments; and
- Paying only reasonable plan expenses.

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# Exclusive Benefit


- Also known as the Duty of Loyalt
- Any form of self-dealing would be considered a breach of duty
  - Understand who a party-in-interest is
  - Beware of engaging in prohibited transactions
    - Some exemptions exist for certain transactions
- Employer stock requires considerable thought and analysis

# Prudent Man Rule

- Must act "with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."
  - ERISA section 404(a)(1)(B)


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# POLL QUESTION

- An owner of a small staff organization is picking out a service provider for it's 401(k) plan. The owner doesn't know much about the different providers. In the end, the owner goes with the 'name brand' provider because they read good online reviews. Is this a prudent decision?
  - YES
  - NO

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# Prudent Man Rule (cont.)

- Actions will be compared to a hypothetical prudent person
- It's the reason why many fiduciaries outsource certain functions
  - Let experts do what experts do

- No requirement to be psychic
- Demonstration of due diligence needed

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# Duty to Monitor

- Selection and oversight of service providers
  - Review should be done at reasonable intervals
  - Must ensure performance complies with terms of the plan and all statutory requirements
- Liable for acts or omissions of the service provider if there is knowledge of a breach
- Amount of compensation must be reasonable compared to services rendered

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# How to Monitor

- Establish a formal review proces
  - Review service providers' performance
  - Review the reports provided
  - Review actual fees charged
  - Ask about policies and procedures
  - Follow-up on any participant complaints

  www.dol.gov/ebsa/publications/ fiduciaryresponsibility.html

# Importance of Fees

- A party-in-interest may not receive compensation from the plan
  - A service provider is a party-in-interest, so how can they be paid???
  - Covered service providers may be paid a "reasonable" amount to be exempt
- Determination of reasonableness is made by the Fiduciary/Plan Spon

# Determining Reasonableness

- Must receive 408(b)(2) Disclosure from all covered service providers that include –
  - Description of services provided
  - All direct/indirect compensation received
    - Identify where indirect compensation comes from
  - Annual operating expenses (e.g. expense ratios)
- Any changes must be disclosed 60 days in advance

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# So, what if my disclosure is incomplete or missing?

- Employer must request a clarification or missing disclosure
  - If correction is not made, **it is the Plan Sponsor's responsibility to fire the service provider**
  - Not only must they be fired, the service provider must be reported to the DOL
- If the Employer fails to review the 408(b)(2), they become liable for any excessive fees

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# POLL QUESTION

- To comply with the reasonableness standard, the Plan Sponsor MUST find the cheapest option
  – TRUE
  – FALSE

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# What is “reasonable”?

- It is NOT the cheapest service
- It is NOT a name-brand service provider
- It is unique to your plan, your participants, and your needs

# Participant Fee Disclosures

- Required if participant-directed plan
- Must disclose (annually):
  - General plan information
  - Plan Administrative fees
  - Participant level fee and expense information
  - Investment fees and expenses
- 30 day advance notice for any changes


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# Fund Selection Issues

- Participant directed Plans are most common
- 404(c) compliance –
  - Provide a broad range of investment alternatives (at least 3 diversified core options)
  - Participants are able to make investment selections and given sufficient info to do so
  - Access to regular and periodic disclosures of investment related information
  - 404(c) notice of intent for plan to comply

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# Fund Choice Considerations

- Setting goals within your Investment Policy
  - Written goals for selecting funds
  - Minutes should be taken to document decision making process
- Determine the affect of the company demographics
- Consider fees versus rate of return
- Select Qualified Default Investment Alternative (QDIA)

# Understanding Target Date Funds

- Often referred to as a life-cycle fund
- Based on date of birth (5 or 10 year groups)
  - Understanding “to” versus “through”
    - Looking at the Glide Path
  - Structured as a mutual fund with shifting objectives as it gets closer to maturity date
- No guarantee for gains/losses
- Doesn’t guarantee will reach retirement goals

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# Selection Criteria

- How many funds should a plan offer?
- What is the difference between fund classes?
- Are there trading restrictions?
  - Sales loads
  - Put options


- What are the fees associated with the funds?
- How have the funds traditional performed when benchmarked against similar funds?

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# Litigation/Audit Landscape

- Department of Labor Investigations
  - May result penalties/sanctions
  - May refer to the IRS if there are tax implications
  - Focus is on protecting Participant benefits/rights
  - Often LONG and painful
- Internal Revenue Service Audits
  - Focus is on compliance with the Tax Code
  - Looks at actual operation of the plan

# Recent Court Decisions

- White et. al. v. Chevron Corp.
  - Court found in favor of defendant
  - Plaintiffs accused Chevron of breach of loyalty and prudence because of funds offered
  - Why did they win?
    - **Documentation showed oversight/monitoring was done**
    - Hindsight is not required
    - Fees do not have to be the cheapest

# Recent Court Decisions (cont.)

- Tussey v. ABB
  - Accusation of breach of duty of loyalty and prudence
  - Used Fidelity funds and Fidelity RK services, creating a revenue-sharing arrangement
  - Excessive fee claims
  - No documentation supporting decision-making
  - Spent years in court

# Recent Court Decisions (cont.)

- Tibble v. Edison
  - Breach of fiduciary duty of loyalty and prudence
  - Continuing duty to monitor
  - “Set it and forget it” doesn’t apply
  - Failed to review fees associated with funds
  - Must document decision-making process


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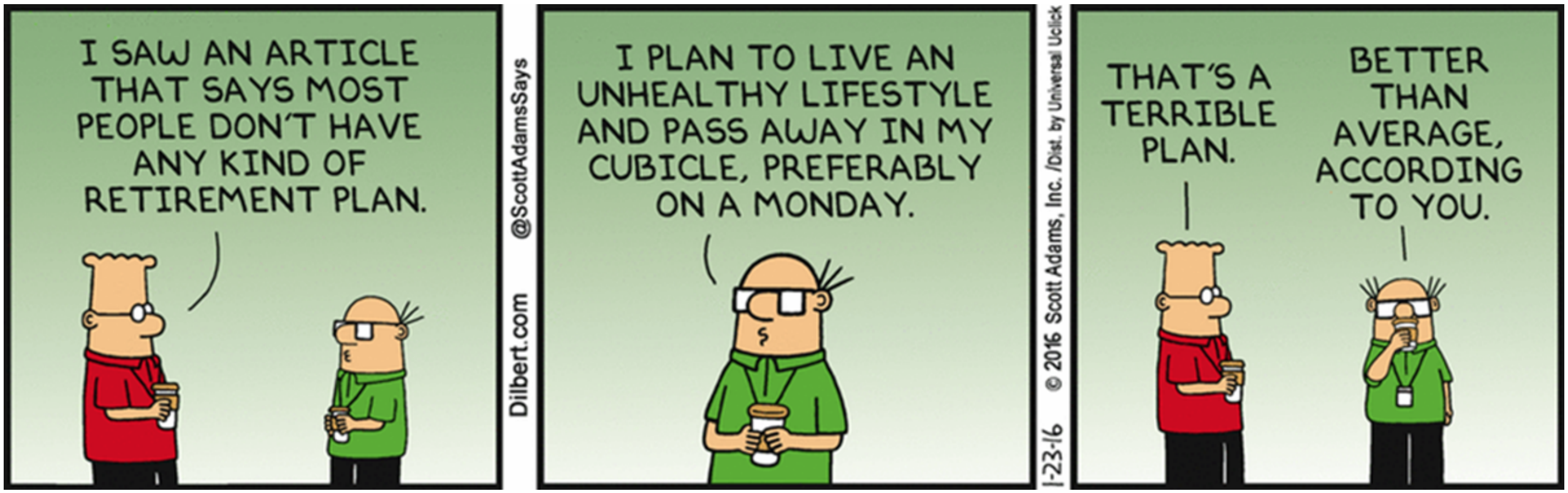
# Financial Wellness

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# Financial Wellness (cont.)

- Retirement Readiness
  - How ready is your workforce for retirement?
  - Will your employees be able to meet their retirement needs?
  - What outside forces affect an employee's ability to save for retirement?
    - Understanding the Sandwich Generation and their unique challenges

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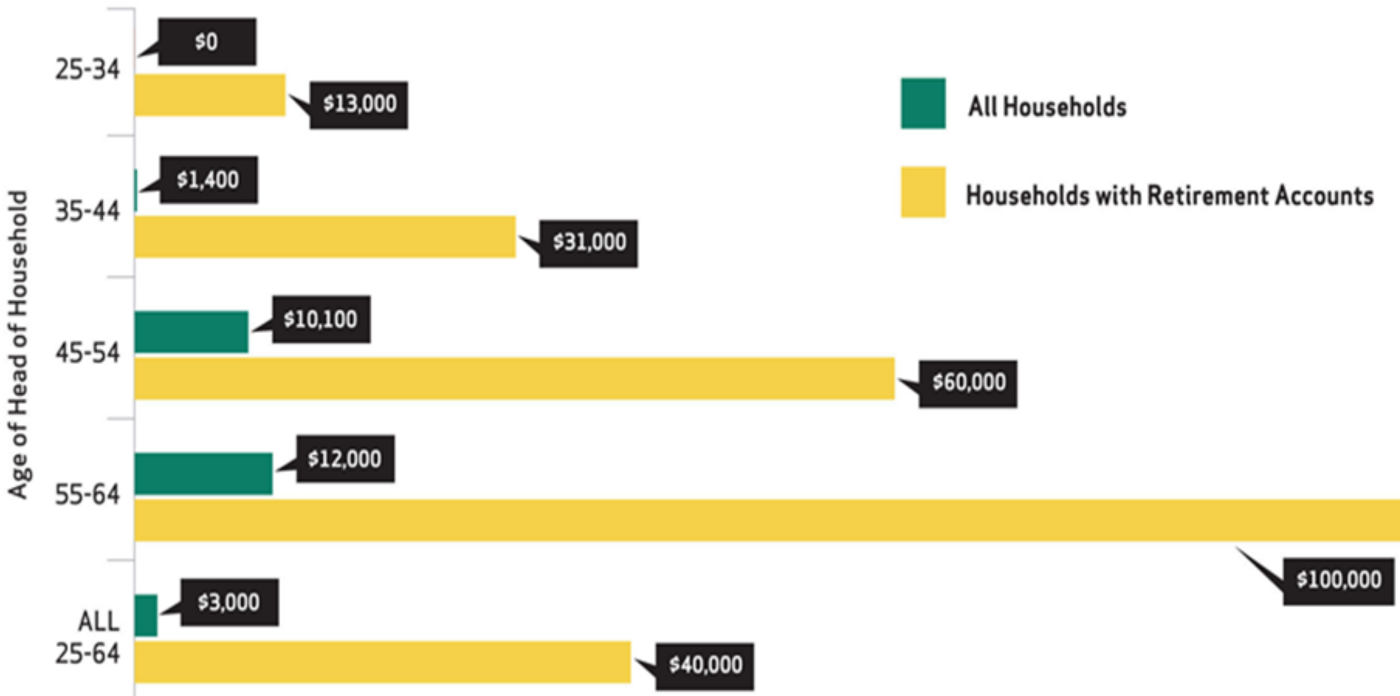
# Financial Wellness (cont.)

Figure 9: **Typical Working-Age Household Has Only $3,000 in Retirement Account Assets; Typical Near-Retirement Household Has Only $12,000**

Median retirement account balances, households with retirement accounts vs. all households, 2010




Source: National Institute on Retirement Security - The Retirement Savings Crisis: Is it Worse Than We Think? | www.nirsonline.org

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# Financial Wellness (cont.)

- Why should employers care about the financial wellness of their employees?
  - Parental Answer – It feels good
  - Financial Answer – It affects the bottom line
    - Increased health care premiums
    - Employees unable to retire (higher cost)
    - Inability to attract talented employees
    - Burden on social safety net – increased taxes/costs

# How Employers Can Help

- Employer provided information
  - Investment Education Access
  - Employee assistance programs
  - Resource materials
    - Company intranet site
    - Employee breakroom
    - Brochures, local resources, 800#
    - Eldercare locator service (www.eldercarelocator.gov or 1-800-667-1166)
  - Only seven percent of employees look to HR for info

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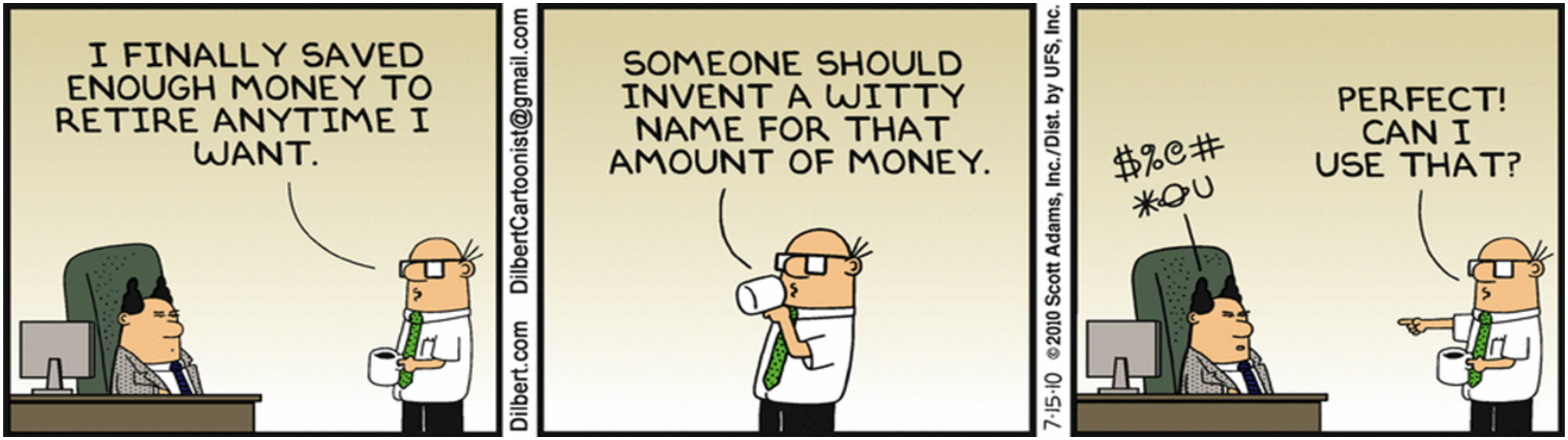
# Closing Thoughts

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# Questions?

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